No. 10185

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

UNITED STATES OF AMERICA,

Appellant,

vs.

AUSTEN G. BROWN and MARIAN B. KENYON, Executors of the Estate of FREDERICK L. BROWN, Deceased,

Appellees.

Upon Appeal from the District Court of the United States for the Southern District of California, Central Division.

BRIEF FOR THE UNITED STATES.

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BRIEF FOR THE UNITED STATES.

Opinion Below.

The opinion of the District Court [minute order and memorandum decision, R. 41-43] is unreported.

Jurisdiction.

This is an action for the recovery of estate taxes paid. The complaint, filed February 13, 1941 [R. 1-35], alleges that the taxes were wrongfully exacted and that the claim for refund, filed December 15, 1939, was rejected on April 1, 1940 [R. 7-8]; also, that the action is brought under Section 24 (20) of the Judicial Code, as amended (U. S. C., Title 28, Sec. 41 (20)). [R. 2.] The case is brought to this Court by notice of appeal filed February

25, 1942 [R. 55], from the judgment of the District Court entered November 25, 1941. [R. 53-54.] The jurisdiction of this Court is invoked under Section 128 (a) of the Judicial Code, as amended (U. S. C., Title 28, Sec. 225).

Question Presented.

In 1923 the decedent created an irrevocable trust, providing for distribution of the income in varying proportions to himself and family. During his lifetime, the decedent actually received 31 per cent of the total trust income. The trust was to terminate upon the death of the survivor of the decedent and his wife, whereupon the corpus was to vest absolutely in equal shares in their children, if living. If any child should then be dead, his share was to vest in his issue and/or spouse in stated proportions, and in default of issue or spouse the share would vest as if that child had not been named as a remainderman. The decedent died in 1934. The question is whether 31 per cent of the value of the trust corpus is includible in the gross estate as a transfer intended to take effect in possession or enjoyment at or after death under Section 302 (c) of the Revenue Act of 1926.

Statute and Regulations Involved.

The pertinent statutory provisions are set forth and the regulations are mentioned in the appendix, *infra,* pages 13 to 18.

Statement.

The case was tried without a jury. [R. 45.] A stipulation of facts was filed [R. 39-40, 45] and oral and documentary evidence was also received. [R. 45, 62-66.] Thereafter the District Court rendered its decision in writing [R. 41-43, 45], with special findings of fact and conclusions of law. [R. 45-51.] Judgment was entered for the taxpayers in the principal sum of $9,534.40 [R. 53-54], from which the defendant took this appeal.

The facts are undisputed. So far as material, they may be summarized as follows [R. 13-27, 39-40, 45-50]:

The taxpayers are the executors of the last will and testament of Frederick L. Brown, who died on the 8th day of August, 1934, at the age of 67 years. On August 15, 1923, the decedent and his wife, who is now also deceased, created an irrevocable trust whereby he transferred to himself and their two sons (Walton Brown and Austen G. Brown) as trustees, 130¼ shares of capital stock of Gardena Syndicate, then owned by the decedent. [R. 45-48.]

The trust indenture provided that the decedent should receive the first $30,000 of the trust income. Thereafter, the trustees were to pay him during his life $500 per month out of income. A similar monthly income was then to be paid to his wife. Subject to an accumulation to secure the foregoing payments, the balance of the income was distributable mainly to their three children. [R. 21-23, 48.] In accordance with these provisions of the

trust agreement, the decedent actually received during his lifetime 31 per cent of the total trust income. [R. 14-15.]

The trust was to terminate upon the death of the survivor of the decedent and his wife. Thereupon, the corpus was to vest absolutely in equal shares in their children, if living. If any child should then be dead, his share was to vest in his issue and spouse in stated proportions. In default of issue or spouse the share would vest as if that child had not been named as a remainderman. [R. 24-25.]

No right of alteration or amendment, or other right of revocation or control was retained by the decedent or his wife, either alone or with any other person. The trust was in full force at the time of the decedent's death in 1934. It terminated according to its terms upon the death of the wife, on February 8, 1940. [R. 46-47.]

The estate tax return filed by the executors in 1935 with the Collector of Internal Revenue for the Sixth District of California, disclosed no estate tax to be due. The Commissioner of Internal Revenue thereafter determined a deficiency in the estate tax of $9,534.60, with interest. This resulted from the inclusion in the gross estate of the value ($142,552.05) of 31 per cent of the 130¼ shares of stock of the Gardena Syndicate, which the decedent had transferred in trust in 1923. The Commissioner's action was based upon Section 302 (c) of the Revenue Act of 1926, as amended. [R. 48-49.]

In April of 1940 the Commissioner rejected a claim for refund filed the preceding December. This suit was then filed, and resulted in a judgment in favor of the taxpayers.

The District Court concluded that the decedent had not made a transfer intended to take effect in possession or enjoyment at or after death. The United States thereupon took this appeal. [R. 49-50.]

Statement of Points to Be Urged.

The court below erred (1) in holding that the value of 31 per cent of the corpus of the trust created by the decedent in 1923, was not includible in his gross estate under Section 302 (c) of the Revenue Act of 1926; (2) in entering judgment for the taxpayers in the principal sum of $9,534.40.

Summary of Argument.

The decedent made a transfer by trust which was intended to take effect in possession or enjoyment at or after his death, within the meaning of Section 302 (c) of the Revenue Act of 1926. This is true because the rights of the remaindermen were in fact contingent upon their surviving the decedent. Thus, the ultimate disposition of the corpus of the trust was suspended during the lifetime of the decedent.

Moreover, at least 31 per cent of the trust corpus is includible in the gross estate under Section 302 (c), because the decedent received that portion of the trust income during his lifetime, pursuant to an express reservation in the trust indenture. Such a reservation is sufficient in itself to justify the conclusion that the transfer was intended to take effect at death.

In any event, the validity of the foregoing conclusion becomes apparent when the provisions of the trust indenture are considered as a whole.

ARGUMENT.

The Decedent Made a Transfer by Trust Which Was Intended to Take Effect in Possession or Enjoyment at or After His Death.

The only issue in this case is whether, by the trust created in 1923, the decedent made a transfer intended to take effect in possession or enjoyment at or after his death, within the meaning of Section 302 (c) of the Revenue Act of 1926, c. 27, 44 Stat. 9. [Appendix, *infra*, p. 13.] In contending that he did make such a transfer, we rely upon the trust provisions for disposition of corpus, and for the reservation to the decedent of a life interest in a substantial portion of the trust income. Either provision is sufficient in itself to justify inclusion in the gross estate of 31 per cent of the value of the trust corpus.[1] In any event, the two combined show clearly that the decedent made a transfer intended to take effect at death.

a. The Ultimate Disposition of the Trust Corpus Was Suspended During the Lifetime of the Decedent.

The trust created in 1923 was to terminate upon the death of the survivor of the decedent and his wife. "Thereupon," the indenture provides, "the title to said trust property shall vest absolutely in equal shares in" the three children, if living. Thus, it is apparent that the ultimate disposition of the corpus of the trust was suspended during the lifetime of the decedent.

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[1] In determining the deficiency, the Commissioner included only 31 per cent of the corpus because that represented the portion of the trust income which the decedent received during his lifetime. The entire corpus would properly be includible if we are right in our first argument. However, no increased deficiency has been asserted.

The statute couples transfers intended to take effect at death with transfers made in contemplation of death, and evinces an intention to treat them alike. It was clearly designed to reach substitutes for testamentary dispositions and thus to prevent evasion of the estate tax. (*United States v. Wells*, 283 U. S. 102, 116-117.) We submit that the instant transfer was a substitute for a testamentary disposition in a very real sense since it provided for the distribution of the bulk of the grantor's property after his death.[2]

We are not obliged to maintain that there was a "transfer" of the trust property from the decedent to others *at his death*. *Tyler v. United States*, 281 U. S. 497, 502; *United States v. Jacobs*, 306 U. S. 363, 367, rehearing denied, 306 U. S. 620. The statute contemplates the inclusion of property donatively transferred where the possession or enjoyment of the ultimate taker is deferred until at or after the donor's death (*cf. Helvering v. Hutchings*, 312 U. S. 393; *United States v. Pelzer*, 312 U. S. 399; *Ryerson v. United States*, 312 U. S. 405). This is clearly such a case because the rights of the remaindermen were in fact contingent at all times during the lifetime of the survivor of the grantor and his wife. In other words, the rights of the remaindermen could not become indefeasibly fixed until at or after the grantor's death.

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[2]It is immaterial that there may have been completed gifts upon the creation of the trust. *Hughes v. Commissioner*, 104 F. (2d) 144 (C. C. A. 9th); *Herzog v. Commissioner*, 116 F. (2d) 591 (C. C. A. 2d). The same is true of gifts in contemplation of death. Nevertheless, such gifts are subject to estate tax when the donor dies. *Fish v. Helvering*, 75 F. (2d) 769 (App. D. C.). See *Estate of Sanford v. Commissioner*, 308 U. S. 39, 45; *Herzog v. Commissioner*, *supra*, p. 595. No gift tax was paid on the instant transfer, because the trust was created prior to adoption of the first gift tax law in 1924.

Our view is supported by *Helvering v. Hallock,* 309 U. S. 106. The decedent had there created a trust to pay the income to his wife for life and upon her death to deliver the principal to the grantor, if living. If he should not then be living, the property was to go to his children. The garntor predeceased his wife and the Court held that the value of his interest[3] was properly includible in the gross estate as a transfer intended to take effect at or after death. In so holding, the Court expressly overruled its own prior decisions in the *St. Louis Trust Co.* cases (*Helvering v. St. Louis Trust Co.*, 296 U. S. 39; *Becker v. St. Louis Trust Co.,* 296 U. S. 48) and said (pp. 110-111):

> Whether the transfer made by the decedent in his lifetime is "intended to take effect in possession or enjoyment at or after his death" by reason of that which he retained, is the crux of the problem. We must put to one side questions that arise under sections of the estate tax law other than Section 302 (c) —sections, that is, relating to transfers taking place at death. Section 302 (c) deals with property not technically passing at death but with interests theretofore created. The taxable event is a transfer *inter vivos.* But the measure of the tax is the value of the transferred property at the time when death brings it into enjoyment.

In the instant case there was a possibility of reverter, remote though it may have been, and the eventual dispo-

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[3]The Commissioner did not attempt to include the value of the entire corpus but deducted therefrom the value of the wife's outstanding life interest. Under the rationale of the Court's decision, it is believed that the entire value could have been included and that the court in *Central Nat. Bank of Cleveland v. United States,* 41 F. Supp. 239 (C. Cls.) erred (p. 248) in concluding to the contrary.

sition of the property under the deed of trust was fixed with reference to the decedent's death. The gifts to the remaindermen did not and could not take effect in possession or enjoyment until at or after the happening of that event.

The *Hallock* case has not been restricted to its precise facts. It has been applied in other cases presenting analogous situations. Some of these cases are as follows: *Commissioner v. Clise,* 122 F. (2d) 998 (C. C. A. 9th), certiorari denied, March 30, 1942; *Commissioner v. Wilder's Estate,* 118 F. (2d) 281 (C. C. A. 5th), certiorari denied, 314 U. S. 634; *Chase Nat. Bank v. United States,* 116 F. (2d) 625 (C. C. A. 2d); *Commissioner v. Washer,* 127 F. (2d) 446 (C. C. A. 6th), petition for certiorari pending; *Van Vranken v. Helvering,* 115 F. (2d) 709 (C. C. A. 2d), certiorari denied, 313 U. S. 585; *Chase Nat. Bank of City of New York v. Higgins,* 38 F. Supp. 858 (S. D. N. Y.). *Cf.* also *Helvering v. Le Gierse,* 312 U. S. 531. On the other hand, the court in *Commissioner v. Kellogg,* 119 F. (2d) 54 (C. C. A. 3d), gave the *Hallock* case a narrow interpretation. However, we submit that the *Kellogg* case was incorrectly decided.

For the foregoing reasons, we maintain that the instant transfer is taxable under Section 302 (c).

b. The Transfer Was Intended to Take Effect at Death to the Extent That the Decedent Reserved a Life Interest in the Trust Income.

In advancing this alternative contention based upon the decedent's reservation of a life interest in a substantial part of the trust income, we are not unmindful of the decision of the Supreme Court in *Hassett v. Welch,* 303 U. S. 303. That case held that, notwithstanding Section

302 (h) of the Revenue Act of 1926, the 1931 and 1932 amendments to Section 302 (c) of that Act [Appendix, *infra*, p. 13] were not applicable to transfers made prior to the adoption of the amendments. Since the instant transfer was made in 1923, therefore, we are not relying upon those amendments although they provide expressly for the inclusion of trust property of which the grantor has reserved the income for life.

We now argue that, by reason of the reservation of income here, the decedent made a transfer intended to take effect in possession or enjoyment at his death, within the meaning of Section 302 (c) as it read before the amendments. This of course presents no question of retroactivity because this provision of Section 302 (c) was in effect when the trust was created in 1923,[4] as well as in 1934 when the decedent died. The Supreme Court did not consider this issue in *Hassett v. Welch, supra*, but dealt exclusively with the claimed retroactive operation of the later amendments.

It seems clear that, at least to the extent of 31 per cent of the value of the trust corpus, the remaindermen came into possession and enjoyment of the property only upon the death of the decedent. In reserving that much of the income from the property, the decedent obviously retained the most substantial present incident of ownership. Assuming for this purpose that the remainder interests were "vested in title" (see argument under point a, *supra*), the transfer plainly did not take effect in possession or enjoyment so long as the decedent was receiving the income. This would seem to be one case which Sec-

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[4]See Section 402 (c) of the Revenue Act of 1921, c. 136, 42 Stat. 227.

tion 302 (c) in its original form was certainly intended to cover. See *Nichols v. Coolidge*, 274 U. S. 531, 542-543. The state courts have uniformly so held in construing identical provisions. See annotation in 100 A. L. R. 1244, 1248-1251.

It is true that the Supreme Court held to the contrary in *May v. Heiner*, 281 U. S. 238. But we believe that case is no longer the law in view of the later decision in *Helvering v. Hallock, supra*. Mr. Justice Roberts, dissenting in the *Hallock* case, so construed the majority opinion. Moreover, the Board of Tax Appeals has unequivocally so held in *Hughes v. Commissioner*, 44 B. T. A. 1196, where the facts are substantially the same as in the case at bar. See also, *Reynolds v. Commissioner*, 45 B. T. A. 44; *Fish v. Commissioner*, 45 B. T. A. 120.

We submit that the present position of the Board of Tax Appeals is correct, and that the court below therefore erred in its interpretation of the scope of the *Hallock* decision.

c. VIEWING THE INTERESTS RETAINED BY THE DECEDENT AS A WHOLE, THE TRANSFER TOOK EFFECT AT DEATH.

Experience with the doctrine of *Helvering v. Clifford*, 309 U. S. 331, demonstrates that the combination of several factors may result in tax consequences beyond those reached where one or more of the factors appears in isolation. That approach seems equally appropriate here. It is not necessary to consider the provisions of the trust indenture piecemeal.

While we believe that the tax here can be sustained upon either of the grounds advanced above, when the interests

retained by the decedent are viewed as a whole, it seems plain that he made a transfer intended to take effect in possession or enjoyment at death. No child could have any assurance that a share of the corpus would vest in him until the death of the decedent and his wife. Moreover, in no event could the remainderman come into actual possession and enjoyment of that part of the property from which the decedent was receiving income until after his death. A consideration of these factors in combination, clearly leads to the conclusion that the decedent made a transfer falling within the statute.

Conclusion.

The judgment of the court below should be reversed.

Respectfully submitted,

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September, 1942.

APPENDIX.

Revenue Act of 1926, c. 27, 44 Stat. 9:

SEC. 302 [as amended by Section 404 of the Revenue Act of 1934, c. 277, 48 Stat. 680]. The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated, except real property situated outside the United States—

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(c) [as originally enacted] To the extent of any interest therein of which the decedent has at any time made a transfer, by trust or otherwise, in contemplation of or intended to take effect in possession or enjoyment at or after his death, except in case of a bona fide sale for an adequate and full consideration in money or money's worth. * * *

(c) [as amended by Joint Resolution of March 3, 1931, Public, No. 131, 71st Cong., and by Section 803 (a) of the Revenue Act of 1932, c. 209, 47 Stat. 169]. To the extent of any interest therein of which the decedent has at any time made a transfer, by trust or otherwise, in contemplation of or intended to take effect in possession or enjoyment at or after his death, or of which he has at any time made a transfer, by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death (1) the possession or enjoyment of, or the right to the income from, the property, or (2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom; except in case of a bona fide sale for an adequate and full consideration in money or money's worth. * * *

Treasury Regulations 80 (1937 ed.):

Art. 15 [as amended by T. D. 5008, 1940-2 Cum. Bull. 286]. *Transfers during life.*—The following classes of transfers made by the decedent prior to his death, whether in trust or otherwise, if not constituting bona fide sales for an adequate and full consideration in money or money's worth, are subject to the tax: (1) transfers in contemplation of death (see article 16); (2) transfers conditioned upon the decedent's death (see article 17); (3) transfers under which the decedent reserved or retained (in whole or in part) the use, possession, rents, or other income or enjoyment of the transferred property, for his life, or for a period not ascertainable without reference to his death, or for a period of such duration as to evidence an intention that it should extend to his death; including also the reservation or retention of the use, possession, rents, or other income, the actual enjoyment of which was to await the termination of a transferred precedent interest or estate (see article 18); * * *.

The value of transferred property includible in the gross estate is the value thereof at the date of decedent's death, * * *. If a portion only of the property was so transferred as to come within the terms of the statute, only a corresponding proportion of the value of the property should be included in ascertaining the value of the gross estate. * * *

* * * * * * * *

Art. 17 [as amended by T. D. 5008, *supra*]. *Transfers conditioned upon survivorship.*—The statutory

phrase, "a transfer * * * intended to take effect in possession or enjoyment at or after his death," includes a transfer by the decedent prior to his death (other than a bona fide sale for an adequate and full consideration in money or money's worth) whereby and to the extent that the beneficial title to the property transferred (if the transfer was in trust), or the legal title thereto (if the transfer was otherwise than in trust), is not to pass from the decedent to the donee unless the decedent dies before the donee or another person, or its passing is otherwise conditioned upon decedent's death; or, if title passed to the donee, it is to be defeated and the property is to revert to the decedent as his own should he survive the donee or another person, or the reverting of the property to the decedent is conditioned upon some other contingency terminable by his death. Since in such transfers the decedent's death is requisite to a termination of his interest in the property, it is unimportant whether his interest be denominated a reversion or a possibility of reverter, whether it arose by implication of law or by the express terms of the instrument of transfer, and whether the interest of the donee be contingent or vested subject to be divested, and the tax will apply, unless otherwise provided in the next succeeding paragraph, without regard to the time when the transfer was made, whether before or after the enactment of the Revenue Act of 1916. Thus, upon a transfer by a decedent of property in which an estate for life is given to one and an estate in remainder to another, but with a provision added that the estate in remainder shall revest

in the decedent should he survive the owner of the life estate, there is to be included, in determining the value of the decedent's gross estate following his death, the value as of the date of his death of the estate in remainder, if the life estate is then outstanding. The value of the outstanding life estate is not to be included in determining the value of the gross estate, unless that estate had been transferred in contemplation of the decedent's death, or otherwise as to render it a part of the gross estate. If by reason of an election by the executor the valuation of the gross estate is governed by the provisions of article 11, adjustments in the values of such transferred estates may be required. (See article 15.)

Where the transfer was made during the period between November 11, 1935 (that being the date upon which the Supreme Court of the United States rendered its decisions in the cases of *Helvering v. St. Louis Union Trust Co.* (296 U. S., 39 [Ct. D. 1047, C. B. XIV-2, 339 (1935)]) and *Becker v. St. Louis Union Trust Co.* (296 U. S., 48 [Ct. D. 1046, C. B. XIV-2, 337 (1935)]) and January 29, 1940 (that being the date upon which such Court rendered its decisions in *Helvering v. Hallock* and companion cases (309 U. S., 106 [Ct. D. 1440, C. D. 1940-1, 223]), and the Commissioner, whose determination therein shall be conclusive, determines that such transfer is classifiable with the transfers involved in such two cases decided on November 11, 1935, rather than with the transfer involved in the case of *Klein v. United States* (283 U. S., 231 [Ct. D. 333, C. B.

X-1, 462 (1931)]), previously decided by such Court, then the property so transferred shall not be included in the decedent's gross estate under the provisions of this article, if the following condition is also met: Such transfer shall have been finally treated for all gift tax purposes, both as to the calendar year of such transfer and subsequent calendar years, as a gift in an amount measured by the value of the property undiminished by reason of a provision in the instrument of transfer by which the property, in whole or in part, is to revert to the decedent should he survive the donee or another person, or the reverting thereof is conditioned upon some other contingency terminable by decedent's death.

Art. 18 [as amended by T. D. 4868, 1938-2 Cum. Bull. 355]. *Transfers with possession or enjoyment retained.* Except in the case of a bona fide sale for an adequate and full consideration in money or money's worth, the gross estate embraces (section 302 (c), as amended) all property transferred by the decedent, whether in trust or otherwise, if he retained or reserved the use, possession, right to the income, or other enjoyment of the transferred property, and if the transfer was made—

(1) At any time after 10:30 p. m., eastern standard time, March 3, 1931, and such retention or reservation is for his life, or for such a period as to evidence his intention that it should extend at least for the duration of his life and his death occurs before the expiration of such period; or

(2) At any time after 5 p. m., eastern standard time, June 6, 1932, and such retention or reservation is for any period mentioned in (1) or for any period not ascertainable without reference to his death.

A reservation for a "period not ascertainable without reference to his death" may be illustrated by a reservation of the right to receive, in quarterly payments, the income of the transferred property where none of the income between the last quarterly payment and decedent's death was to be received by him or his estate; or by a reservation of a life estate following a precedent estate for life or a term of years.

The use, possession, right to the income, or other enjoyment of the property, will be considered as having been retained by or reserved to the decedent to the extent that during any such period it is to be applied towards the discharge of a legal obligation of the decedent, or otherwise for his pecuniary benefit.

If such retention or reservation is of a part only of the use, possession, income, or other enjoyment of the property, then only a corresponding proportion of the value of the property should be included in determining the value of the gross estate.

(See article 15.)